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SUBJECT: GVN CUTS RATES ON FEARS OF SLOWDOWN

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B) Hanoi 1095
C) Hanoi 1158

¶1. (U) In a surprise move on October 21, the State Bank of Vietnam (SBV) issued Decision 2316 lowering the base interest rate to 13 percent from 14 percent. The SBV also cut the discount rate to 12 percent from 13 percent and the re-financing rate to 14 percent from 15 percent. The base interest rate is used by the SBV to determine the maximum lending rates in the country. According to Vietnam's civil code, lending rates cannot exceed 1.5 times the base rate, so the new official cap for lending rates now will be 19.5 percent from 21 percent previously. At the same time, the SBV also injected some liquidity into the system by implementing Decision 2321, doubling the interest rate paid on compulsory reserves by financial institutions to 10 percent from 5 percent, and Decision 2317, pre-paying compulsory bills issued on March 17, 2008 worth VND 20,300 billion (approx. $1.2 billion).

¶2. (SBU) In the announcement issued on the 21st, the SBV states that its actions follow the GNV's instructions to "contain inflation, proactively limit the negative impacts of the global economic recession and financial crisis, ensure macroeconomic stability and sustain reasonable growth." The SBV expects that lower lending rates will ease the credit crunch faced by most businesses, especially small and medium enterprises (reftel A), and therefore lead to economic growth. The SBV attributes the rate cut to recent declines in the Consumer Price Index, which showed a 0.2 per cent monthly increase in September and is expected to fall further in October. The SBV's Monetary Policy officials, however, noted to the Embassy that "the base rate is not fixed. SBV will adjust and determine the base rate in line with market conditions". They also said that "currently there's no change" to the 30 percent credit growth target set by the GVN earlier this year.

¶3. (SBU) Most analysts and economists were surprised by the move in light of recent GVN promises about tight monetary policy through the end of the year (reftel B). The PM recently reinforced those messages in his remarks to the National Assembly on October 16, identifying the GVN's "core task as controlling inflation, stabilizing the macro-economy, ensuring social security and rational and sustainable growth, of which inflation control is the top priority." Both ADB and IMF representatives in Hanoi called the measures "premature" but understandable given easing inflationary pressures and increasing downside risks for both exports and FDI (reftel C).

¶4. (SBU) Comment: Privately, some local economists are saying that these liquidity measures run the risk of sending the wrong signal to the market - that some may see them as another wild swing

in Vietnam's economic policy or as a sign of panic by the GVN. Following the SBV's announcement, the dong depreciated to the top of the official trading band and continues to hover there, perhaps indicating that immediate market reaction is not as positive as hoped. Given the global downturn, the GVN's monetary policy will have to continue to walk the increasingly fine line between mitigating external risks to growth and combating inflationary pressures.

MICHALAK